

January 2003

# Major Management Challenges and Program Risks

## Small Business Administration



G A O

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## A Glance at the Agency Covered in This Report

The Small Business Administration's (SBA) mission is to maintain and strengthen the nation's economy by aiding, counseling, assisting, and protecting the interests of the nation's small businesses. SBA seeks to achieve its mission by:

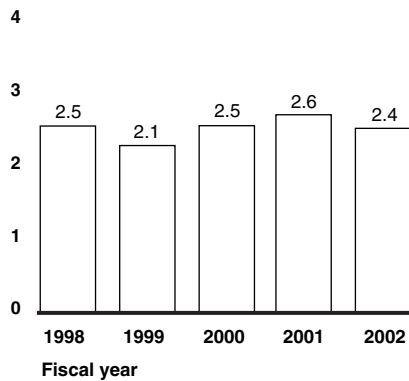
- providing access to credit for small businesses, primarily by guaranteeing bank loans through its 7(a) program;
- helping businesses and households recover from disasters by providing loans directly;
- ensuring that a fair proportion of government purchases and sales, contracts and subcontracts are placed with small businesses;
- offering assistance to entrepreneurs through partnerships with private entities that offer small businesses counseling and technical assistance; and
- administering the 8(a) program, which is designed to help small disadvantaged businesses obtain federal contracts.

## The Small Business Administration's Budgetary and Staff Resources

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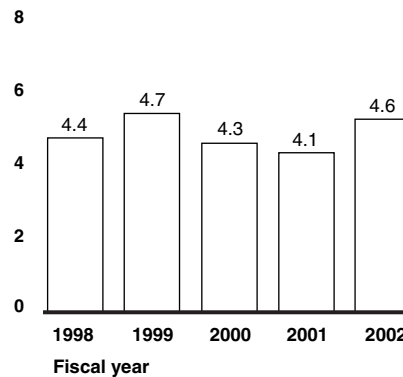
### Budgetary Resources<sup>a, b</sup>

Dollars in billions



### Staff Resources<sup>b</sup>

FTEs in thousands



Source: Budget of the United States Government.

<sup>a</sup> Budgetary resources include new budget authority (BA) and unobligated balances of previous BA.

<sup>b</sup> Budget and staff resources are actuals for FY 1998-2001. FY 2002 are estimates from the FY 2003 budget, which are the latest publicly available figures on a consistent basis as of January 2003. Actuals for FY 2002 will be contained in the President's FY 2004 budget to be released in February 2003.

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## This Series

This report is part of a special GAO series, first issued in 1999 and updated in 2001, entitled the *Performance and Accountability Series: Major Management Challenges and Program Risks*. The 2003 Performance and Accountability Series contains separate reports covering each cabinet department, most major independent agencies, and the U.S. Postal Service. The series also includes a governmentwide perspective on transforming the way the government does business in order to meet 21st century challenges and address long-term fiscal needs. The companion *2003 High-Risk Series: An Update* identifies areas at high risk due to either their greater vulnerabilities to waste, fraud, abuse, and mismanagement or major challenges associated with their economy, efficiency, or effectiveness. A list of all of the reports in this series is included at the end of this report.

## Small Business Administration



Highlights of [GAO-03-116](#), a report to Congress included as part of GAO's Performance and Accountability Series

### Why GAO Did This Study

GAO's 2001 report on major challenges at the Small Business Administration (SBA) addressed lender oversight, the 8(a) program for small disadvantaged businesses, disaster loan processing, and other issues. The information GAO presents in this report is intended to help sustain congressional attention and SBA's focus on addressing these challenges. This report is part of a special series of reports on governmentwide and agency-specific issues.

### What Remains to Be Done

GAO believes that SBA should

- qualitatively assess preferred lenders' performance, and develop new methods to measure the financial risks lenders pose to SBA;
- continue to develop the policies and practices needed to effectively acquire and manage its information technology resources; and
- correct various accounting and budgeting errors and misstatements before conducting additional loan asset sales.

[www.gao.gov/cgi-bin/getrpt?GAO-03-116](http://www.gao.gov/cgi-bin/getrpt?GAO-03-116).

To view the full report, click on the link above. For more information, contact Tom McCool at (202) 512-8678 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov).

### What GAO Found

SBA has addressed some of the specific performance and management challenges that we previously identified. For example, SBA has identified appropriate elements for an effective lender oversight program but has been slow to incorporate all of them. Other challenges continue.

- **Improving lender oversight.** SBA has made progress in developing its lender oversight program but conducts only a cursory review of lenders' processes, not a qualitative assessment of decisions on borrowers' creditworthiness and eligibility. SBA also does not routinely analyze lenders' SBA loan portfolios to assess the financial risk to SBA.
- **Developing better disaster assistance performance measures.** SBA exceeded its timeliness goals, but the measures used provided incomplete information. For example, in measuring customer satisfaction, SBA uses the results of its survey of successful disaster loan applicants; unsuccessful applicants are not surveyed.
- **Strengthening human capital management.** SBA's current organizational structure continues to have weaknesses, such as complex, overlapping relationships among offices, which contribute to its challenges in delivering services to small businesses. SBA has a draft 5-year plan to restructure its workforce and streamline its operations.
- **Ensuring improvement in information technology.** SBA has made some progress in establishing policies and defining processes in information technology investment management but still needs policies for software development and acquisition, and in other areas.
- **Improving budget and financial accountability.** SBA continues to have difficulties producing complete, accurate, and timely financial statements. SBA incorrectly calculated the accounting losses on loan sales and did not perform key analyses to determine the overall financial impact of the sales. These errors and lack of key analyses also mean that congressional decision-makers are not receiving accurate financial data to make informed decisions about SBA's budget and appropriations.

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**Comptroller General  
of the United States**

**United States General Accounting Office  
Washington, D.C. 20548**

January 2003

The President of the Senate  
The Speaker of the House of Representatives

This report addresses the major management challenges facing the Small Business Administration (SBA) as it seeks to maintain and strengthen the nation's economy by aiding, counseling, assisting, and protecting the interests of the nation's small businesses and by helping businesses and individuals recover from disasters. It includes a summary of actions that SBA has already taken and that are under way to address these challenges and outlines further actions that GAO believes are needed.

This analysis should help the new Congress and administration carry out their responsibilities and improve government for the benefit of the American people. For additional information about this report, please contact Thomas J. McCool, Managing Director, Financial Markets and Community Investment, at (202) 512-8678 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov).

David M. Walker  
Comptroller General  
of the United States

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# Major Performance and Accountability Challenges

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In our January 2001 report on major management challenges and program risks at the Small Business Administration (SBA),<sup>1</sup> we addressed four issues. First, we noted that SBA needed to improve its oversight of its lending partners, including the need to develop a data system for monitoring its guaranteed loans and lending partners. This challenge has become increasingly important as SBA pursues its policy of delegating credit decisions to lenders. Second, we described how SBA's program to provide business development and federal contract support to small disadvantaged businesses (the 8(a) program) needs to be refocused to more effectively assist firms in obtaining contracts. SBA's ability to assess the effectiveness of this program was limited by a lack of information on the views and needs of 8(a) customers and an inadequate information system. Third, we addressed SBA's ongoing efforts to streamline and modernize disaster loans processing. We reported that SBA's data showed improvements in the timeliness of loan processing but noted that the agency needed to get more input from loan applicants and to further automate its loan processing procedures. Finally, we described how SBA's overall performance in human capital management, information technology, and budgetary and financial accountability needed to be strengthened.

Changes since January 2001 in the economic health and security of our nation have heightened the significance of how SBA performs. Stresses in the economy can result in a tightening of available credit and SBA guaranteed loans, technical assistance, and counseling provided to businesses in partnership with private entities may be in higher demand during economic downturns. The September 11, 2001, terrorist attacks brought additional challenges to SBA in providing assistance in the wake of the largest disaster since the 1994 Northridge earthquake. In addition, the need for assistance extended nationwide, not just in the immediate areas of the attacks. SBA, working with Congress, adapted its disaster loan program to address the unique circumstances presented by the September 11 attacks.

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<sup>1</sup>U.S. General Accounting Office, *Major Management Challenges and Program Risks: Small Business Administration*, [GAO-01-260](#) (Washington, D.C.: January 2001).

All of the 2001 performance and accountability challenges remain, although SBA has made some progress in addressing them. For example, although SBA now performs reviews of more of its preferred lending partners, the reviews—and SBA’s oversight program in general—do not address key issues, such as borrowers’ creditworthiness and eligibility or the financial risk lenders’ SBA portfolios pose to SBA. The tragedy of September 11 challenged SBA’s disaster loan program, but with congressional input, SBA modified some of its standard policies and procedures to expedite and broaden its response to affected businesses. In July 2002, SBA’s new leadership team announced a 5-year workforce transformation plan, in part, on the basis of the need for change identified in our work.<sup>2</sup> Further, SBA has made some progress in addressing our recommendations for improving its information technology management capabilities, but more remains to be done before the agency can effectively acquire and manage the information technology resources it needs. Finally, SBA has improved its financial reporting process for fiscal year 2001 but continues to have problems producing complete, accurate, and timely financial statements. This report discusses these ongoing challenges at SBA and the agency’s efforts to address them.

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<sup>2</sup>Lloyd A. Blanchard, Chief Operation Officer, U.S. Small Business Administration, statement before the Subcommittee on Workforce, Empowerment and Government Programs, Committee on Small Business, U.S. House of Representatives, July 16, 2002.

## Performance and Accountability Challenges



- Improve oversight of SBA's preferred lenders
- Increase the number of small disadvantaged businesses that benefit from the 8(a) program
- Develop a better performance plan for the Disaster Loan Program
- Strengthen human capital management
- Ensure improvements in information technology
- Improve budget and financial accountability for loan asset sales

### SBA Needs to Continue Improving Its Oversight of Its Preferred Lenders

Lender oversight has become increasingly important as SBA, in its role of providing credit or access to credit for small businesses, continues to delegate loan approval authority to lending partners that make SBA-guaranteed loans to small businesses. SBA's largest business loan program, 7(a), is intended to serve small businesses that cannot obtain credit elsewhere. Under this program, SBA provides loan guarantees of up to 85 percent of the loan value. In fiscal year 2001, approximately 500 preferred lenders approved \$5.3 billion of the approximately \$9.9 billion in 7(a) loans granted. These lenders, which have full authority to make 7(a) loans without prior SBA approval, are primarily banks but also include Small Business Lending Companies (SBLC) licensed by SBA. Currently, 12 of the 14 SBLCs are preferred lenders; they account for 19 percent of 7(a) lending dollar volume.

SBA has shared oversight responsibility for the private preferred lenders in its 7(a) program and complete responsibility for overseeing SBLCs. Because private lenders have federal bank regulators, such as the Office of the Comptroller of the Currency, that oversee their overall financial safety



and soundness, SBA's oversight focuses on the lenders' SBA loan portfolios (including risk-management strategies) and compliance with program requirements. SBLCs, however, have no regulators other than SBA, which is therefore responsible for examining their financial condition as well as their portfolios and compliance with 7(a) policies and procedures.

Since our June 1998 report on SBA's lender oversight in general and our November 2000 report on SBLC oversight,<sup>3</sup> SBA has made progress in developing a program to oversee its preferred lenders. The agency has built oversight capabilities, identifying appropriate elements for an effective program, initiating a safety and soundness examination program for SBLCs, and reviewing more preferred lenders more often, but it has been slow in fully implementing other changes. These include routine analyses of risk in lenders' SBA loan portfolios, further developing safety and soundness examinations of SBLCs, performing more substantive compliance reviews, consolidating responsibilities for oversight within the agency, and establishing an effective information technology system for monitoring loans. SBA's Office of the Inspector General (OIG) has also noted SBA's progress in addressing the challenge of improving lender oversight.<sup>4</sup>

SBA has not taken two important steps to address risk-management issues related to lenders' SBA loan portfolios. First, it does not routinely analyze the financial risk lenders' SBA loan portfolios pose to SBA; second, its current reviews are not designed to evaluate decisions on borrowers' eligibility. However, in its strategic plan and in public statements by senior officials, SBA has said that risk-management issues have assumed a higher priority since SBA moved from direct lending to guaranteeing loans made by lending partners.

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<sup>3</sup>U.S. General Accounting Office, *Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted*, [GAO/GGD-98-85](#) (Washington, D.C.: June 11, 1998) and *Small Business Administration: Actions Needed to Strengthen Small Business Lending Company Oversight*, [GAO-01-192](#) (Washington, D.C.: Nov. 17, 2000).

<sup>4</sup>U.S. Small Business Administration, Office of the Inspector General, *FY 2002 Agency Management Challenges* (Jan. 16, 2002).

SBA has contracted with a federal regulator to conduct safety and soundness examinations of SBLCs and advise the agency on ways to improve oversight. But the agency still has not developed specific policies and procedures that require SBLCs to address any weaknesses or unsafe and unsound conditions identified during examinations as we recommended in 2000. In our December 2002 report on preferred lender oversight,<sup>5</sup> we recommended that SBA adopt regulations that define its authority to take supervisory actions against all preferred lenders, including SBLCs, and specify the conditions under which the actions would take place. SBA replied that it is working diligently to address the concerns we raised on this issue.

Although reviews of preferred lenders serve as SBA's primary control mechanism for ensuring compliance with the agency's credit and eligibility standards, we found that the current review process involves a cursory examination of loan files rather than a qualitative assessment of lenders' decisions on borrowers' creditworthiness and eligibility for the program. The Small Business Act states that "no financial assistance shall be extended if the applicant can obtain credit elsewhere."<sup>6</sup> In addition, we found that the "credit elsewhere" standard—a test to determine whether the borrower can obtain credit without the SBA guarantee—is broad, making a meaningful assessment of lenders' decisions difficult. In light of these findings, our 2002 report on preferred lender oversight recommended that SBA develop specific criteria to apply to the credit elsewhere standard and perform qualitative assessments of lenders' performance and lending decisions. In addition, we recommended that SBA incorporate strategies in its review process to adequately measure the financial risk lenders pose to SBA. SBA responded that it was considering approaches for additional methods to assess the financial risk lenders pose and allow for qualitative assessments of its lenders but disagreed with our recommendation that they develop specific criteria to apply to the credit elsewhere standard. We analyzed applicable law, regulations, and SBA procedures that discuss the credit elsewhere standard in reaching our conclusion that the standard is broad, making a meaningful assessment of lenders' decisions difficult. We continue to believe that SBA should develop specific criteria to apply the credit elsewhere standard in a meaningful way.

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<sup>5</sup>U.S. General Accounting Office, *Small Business Administration: Progress Made but Improvements Needed in Lender Oversight*, GAO-03-90 (Washington, D.C.: Dec. 9, 2002).

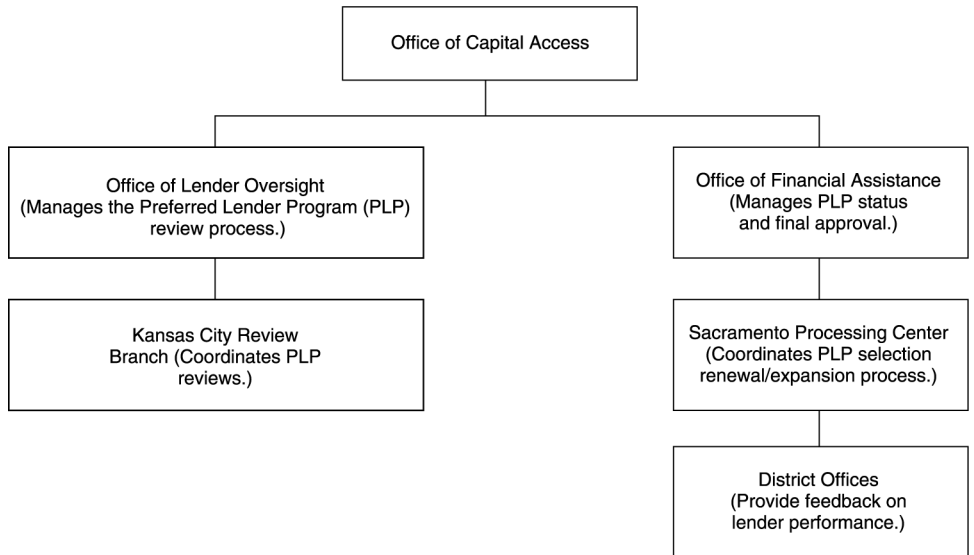
<sup>6</sup>15 U.S.C. section 636(a).

SBA has made lending partner oversight an agency priority. However, SBA does not coordinate this oversight through a single, independent organizational unit with a clearly defined mission, responsibilities, and lines of authority and does not appear to have the staff required to support it. For example, rather than having one office carry out the lender oversight functions, SBA uses two different offices within SBA's Office of Capital Access—the Office of Lender Oversight and Office of Financial Assistance—as shown in figure 1. The Office of Lender Oversight was established in fiscal year 1999 to oversee SBA's lending partners. The Office of Financial Assistance is responsible for promoting the 7(a) loan program and encouraging lender participation. Moreover, the lender oversight may not be conducted independently since the Office of Capital Access is also responsible for promoting the agency's lending program. Locating lender oversight functions in the same office that promotes and implements SBA's lending programs presents a possible conflict of interest. Lastly, staff in the Office of Lender Oversight attributed delays in completing oversight tasks to limited staff resources. For example, sometimes, SBA did not provide final reports to lenders until several months after the lender reviews or SBLC examinations were completed.<sup>7</sup> SBA had no requirement for timely issuance of these reports until recently. A draft policy calls for delivery to lenders within 90 days of completion.

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<sup>7</sup>SBA's OIG also identified as a problem the untimely issuance of SBLC examination reports. See U.S. Small Business Administration, Office of the Inspector General, *Improvements Are Needed in the Small Business Lending Company Oversight Process*, Report Number 2-12 (Mar. 20, 2002).

**Figure 1: Preferred Lender Oversight Responsibilities within the Office of Capital Access**



Source: GAO.

Note: GAO analysis of SBA's Office of Capital Access structure.

In past work analyzing organizational alignment and workload issues,<sup>8</sup> we have described the importance of (1) tying organizational alignment to a clear and comprehensive mission statement and strategic plan and (2) providing adequate resources to accomplish the mission. We found that SBA's Office of Lender Oversight does not currently meet these criteria. Therefore, we recommended in our December 2002 report that SBA separate the lender oversight function from the Office of Capital Access and establish clear authority and guidance on the successor office's program independence, responsibilities, and staffing. SBA appeared to disagree with this recommendation but did not respond to it specifically. In written comments on our report on lender oversight, SBA emphasized that the senior executives heading the Office of Lender Oversight and the Office of Financial Assistance report independently to the head of the Office of Capital Access. We continue to maintain that the current structural alignment and overlapping responsibilities of the oversight functions

<sup>8</sup>U.S. General Accounting Office, *Small Business Administration: Current Structure Presents Challenges for Service Delivery*, [GAO-02-17](#) (Washington, D.C.: Oct. 26, 2001).

within the two offices hinder effective oversight and present the appearance of a conflict, given the promotional and programmatic responsibilities involved.

SBA continues to work toward creating a loan monitoring system (LMS) that will permit better data collection, analysis and evaluation of loans, and lender and program oversight. We are continuing to monitor SBA's progress on this system acquisition effort. In April 2000,<sup>9</sup> we recommended eight steps to help SBA complete planning actions mandated for the LMS, including completing the analyses of benefits and cost of alternatives for each business process identified through SBA's business reengineering effort, completing the definition of specific data quality standards, and developing an acquisition strategy that ensures a sound justification exists for pursuing custom-developed functions. In response, SBA stated that it had completed, initiated, or planned actions for each recommended step. After SBA efforts to develop the LMS experienced cost increases and schedule delays, congressional appropriations committees, in early 2001, asked SBA to develop project and spending plans before spending any additional funds. In June 2002, SBA adopted a new approach for the LMS project that is characterized as more achievable and less risky than the previous approach. This new approach incorporates modernizing the existing loan-related system as individual components, rather than building LMS as a single comprehensive system, and building the lender oversight component as soon as possible.

As a first step in this new approach, in September 2002, SBA awarded a contract for consulting expertise to assist in managing the overall LMS project and addressing mandated planning steps. SBA also plans to award another contract to assist with the development and implementation of a lender oversight system. We are continuing to monitor SBA's progress.

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<sup>9</sup>U.S. General Accounting Office, *SBA Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain*, GAO/AIMD-00-124 (Washington, D.C.: Apr. 25, 2000).

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## 8(a) Program Improvements Are Under Way, but Access to Contracting Has Not Increased

SBA's business development and contracting program for socially and economically disadvantaged small businesses is known as the 8(a) program. Businesses certified to participate in the program are eligible to receive contracts that federal agencies set aside for 8(a) firms and technical assistance and management training from SBA. In fiscal year 2001, almost 7,000 firms participated in the program and 8(a) firms received about \$6.3 billion in federal contracts—about 3 percent of total federal procurement. Since January 2001, SBA has begun to implement short- and long-term strategies to address problems in the 8(a) program. However, recent data suggest that only a few firms continue to receive the bulk of 8(a) funding and that the volume of federal procurement funding awarded to 8(a) firms has not increased.

In our July 2000 report,<sup>10</sup> we found, on the basis of a survey of 1,200 8(a) firms, that almost all of the firms joined the program to obtain 8(a) contracts and wanted SBA to provide contracting assistance. Yet we found that relatively few firms received most of the 8(a) contracts, effectively limiting the developmental opportunities available to other firms in the program. As a result of our findings and our review of SBA's 2001 performance plan, we recommended that SBA take several actions to better meet the purpose of the program, meet the needs and expectations of the firms in the program, and improve the agency's ability to determine how well the program is working. These actions included instructing district offices to place their highest priority on helping inform firms about contracting opportunities, periodically performing a nationwide survey of 8(a) firms to obtain measurable program data, providing a method for collecting data on each firm's training needs, and revising the program's success measure to more meaningfully assess the program's impact. SBA concurred with our recommendations.

SBA has fully implemented one of our four recommendations. SBA revised the program success measure used in the 2001 performance plan. For the 2002 and 2003 performance plans, SBA returned to a measure that it had used previously—the percentage of 8(a) firms that remain viable 3 years after graduating from the 9-year program. An SBA official noted, however, that this measure has limitations. SBA is trying to develop a more effective

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<sup>10</sup>U.S. General Accounting Office, *Small Business: SBA Could Better Focus Its 8(a) Program to Help Firms Obtain Contracts*, GAO/RCEID-00-196 (Washington, D.C.: July 20, 2000).

measure to assess the needs of the 8(a) firms and the program's success. In September 2001, SBA agreed with its Inspector General's recommendations to improve performance measurement for the 8(a) program by the end of fiscal year 2002. According to staff from SBA's CFO, SBA had implemented in December 2002 a tracking system to follow firms that are terminated from the 8(a) program, which was one of the four recommendations.

In addition, SBA has made progress toward implementing the remaining recommendations. SBA has begun instructing district offices to prioritize informing firms about contracting opportunities. For example, its goals for district offices for fiscal year 2001 included obtaining contracts for 5 percent of the 8(a) firms that had been in the program for 2 years or more that did not already have contracts. The district offices also were expected to conduct one procurement training course specifically for 8(a) firms and to inform all 8(a) firms that the course was mandatory. For fiscal year 2002, the 8(a) contracting goal was increased to 10 percent, while the procurement training goal was eliminated. SBA officials indicated that the district offices met the contracting goal for fiscal year 2002. SBA officials also indicated that initial efforts had been made to conduct a nationwide survey of 8(a) firms and to collect data on each firm's training needs. A draft survey was developed, but agency officials indicated that the survey was not finalized due to a lack of funding. SBA did pilot test a software application to identify a firm's training needs, and it plans to incorporate this capability into its information system.

We also reported in July 2000 that SBA's 8(a) information system, which was intended to be a comprehensive monitoring tool, did not meet the information technology needs of either headquarters or district officials. Although program officials have recognized the need to update the system since 1996 and have planned updates, the system has not been substantially improved. SBA officials cited frequent leadership changes at SBA in the late 1990s as the proximate cause of these failures. We recommended that SBA design an integrated 8(a) information system, and SBA concurred. SBA has developed a strategic information technology plan for the 8(a) program that includes an integrated system. However, according an SBA official, implementing the entire plan will require between \$5 and \$7 million and will take at least 5 years.

The 8(a) program is also affected by Executive Order 13170, *Increasing Opportunities and Access for Disadvantaged Businesses*, issued in October 2000. This order mandates nondiscrimination in federal procurement opportunities for small disadvantaged businesses, including 8(a) firms, and requires affirmative action to include these businesses in federal contracting. The order placed several requirements on all executive departments and agencies with procurement authority and gave certain agencies, such as OMB and SBA, additional responsibilities. For instance, each agency was to develop a comprehensive long-term plan to implement the order and submit the plan to OMB within 90 days. OMB's responsibilities included reviewing each comprehensive plan and reporting to the President on the sufficiency of the plans. SBA's responsibilities included establishing 8(a) contracting goals with each agency, reviewing agencies' use of contract bundling,<sup>11</sup> and ensuring that each department's goals and procurement performances were publicly available.

Some progress has been made in implementing the order. According to an OMB official, as of September 2002, several departments and agencies had submitted comprehensive plans, but OMB had not assessed the plans and had not submitted a report to the President. SBA officials reported that they have recommended 8(a) contracting goals for each of the agencies, conducted mid-year evaluation of agencies' achievements, and notified the agencies' of their performance. SBA also conducted a review of contract bundling during fiscal year 2001 and issued a report to Congress. Lastly, contract performance reports for fiscal years 2000 and 2001 are now available to the public on the SBA Web site.<sup>12</sup>

In addition to responding to our recommendations and the executive order, SBA has undertaken other initiatives to improve the 8(a) program. For example, according to SBA officials, SBA has begun trying to expedite the 8(a) award process by enabling federal agencies to work directly with the 8(a) firms. Specifically, SBA has limited its role by passing on to the procuring agency many of the contract procurement functions under a

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<sup>11</sup>Contract bundling is the consolidation of two or more procurement requirements for goods or services previously provided or performed under separate, smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small business. For more information on contract bundling, see U.S. General Accounting Office, *Small Businesses: Limited Information Available on Contract Bundling's Extent and Effects*, GAO/GGD-00-82 (Washington, D.C.: Mar. 31, 2000).

<sup>12</sup>SBA's Web site is <http://www.sba.gov/GC/goals/>.



partnership agreement. As of July 2002, SBA had 29 partnership agreements with other federal agencies. In addition, in January 2002, according to SBA officials, a working group was formed to reexamine the entire 8(a) program and refocus the program on achieving its statutory intent. As part of this effort, the working group is examining such issues as business owners' motivation for participating in the 8(a) program and automating the monitoring process. The working group is exploring both regulatory and statutory strategies to achieve its program goals. As of mid-September 2002, the working group was soliciting comments from SBA staff but had not submitted its report to SBA management for review.

Despite these efforts, the SBA Inspector General reported in January 2002 that the 8(a) program continues to face three serious management challenges: (1) increasing 8(a) firms' access to business development and federal contracts; (2) defining clearer standards to determine "economic disadvantage," a criteria firms must meet to participate in the program; and (3) clarifying rules to deter 8(a) firms from passing through procurement activity to non-8(a) firms.<sup>13</sup> The Inspector General indicated that SBA had made no measurable progress during fiscal year 2001 in addressing these challenges. For example, access to 8(a) funding and the volume of federal procurement funding awarded to 8(a) firms had not increased nationally. We reported that in 1998 about 3 percent of the firms in the 8(a) program received half the dollar value of all 8(a) contract dollars. About half the firms did not receive any contracts.<sup>14</sup> SBA's Inspector General reported similar results for fiscal year 2000.<sup>15</sup> Moreover, federal procurement data indicate that between fiscal years 1998 and 2001 the percentage of total federal contract funding awarded to 8(a) firms declined from 3.6 to 2.9 percent. This trend is in keeping with the recent decline in the proportion of federal procurement awarded to small businesses.<sup>16</sup> At a congressional hearing in February 2002,<sup>17</sup> SBA attributed the decline in 8(a) contracting to several factors, including government credit card purchases, federal supply schedule contracts, and contract bundling.

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<sup>13</sup>U.S. Small Business Administration, Office of the Inspector General, *FY 2002 Update of the Most Serious Management Challenges* (Jan. 16, 2002).

<sup>14</sup>GAO/RCED-00-196.

<sup>15</sup>U.S. Small Business Administration, Office of the Inspector General, *Most Serious Management Challenges* (Jan. 16, 2002).

<sup>16</sup>U.S. General Accounting Office, *Small Business: Trends in Federal Procurement in the 1990s*, GAO-01-119 (Washington, D.C.: Jan. 18, 2001).

<sup>17</sup>*The President's Proposed Budget for the Small Business Administration Fiscal Year 2003*, hearing before the Committee on Small Business, U.S. House of Representatives, Serial No. 107-43, February 13, 2002.

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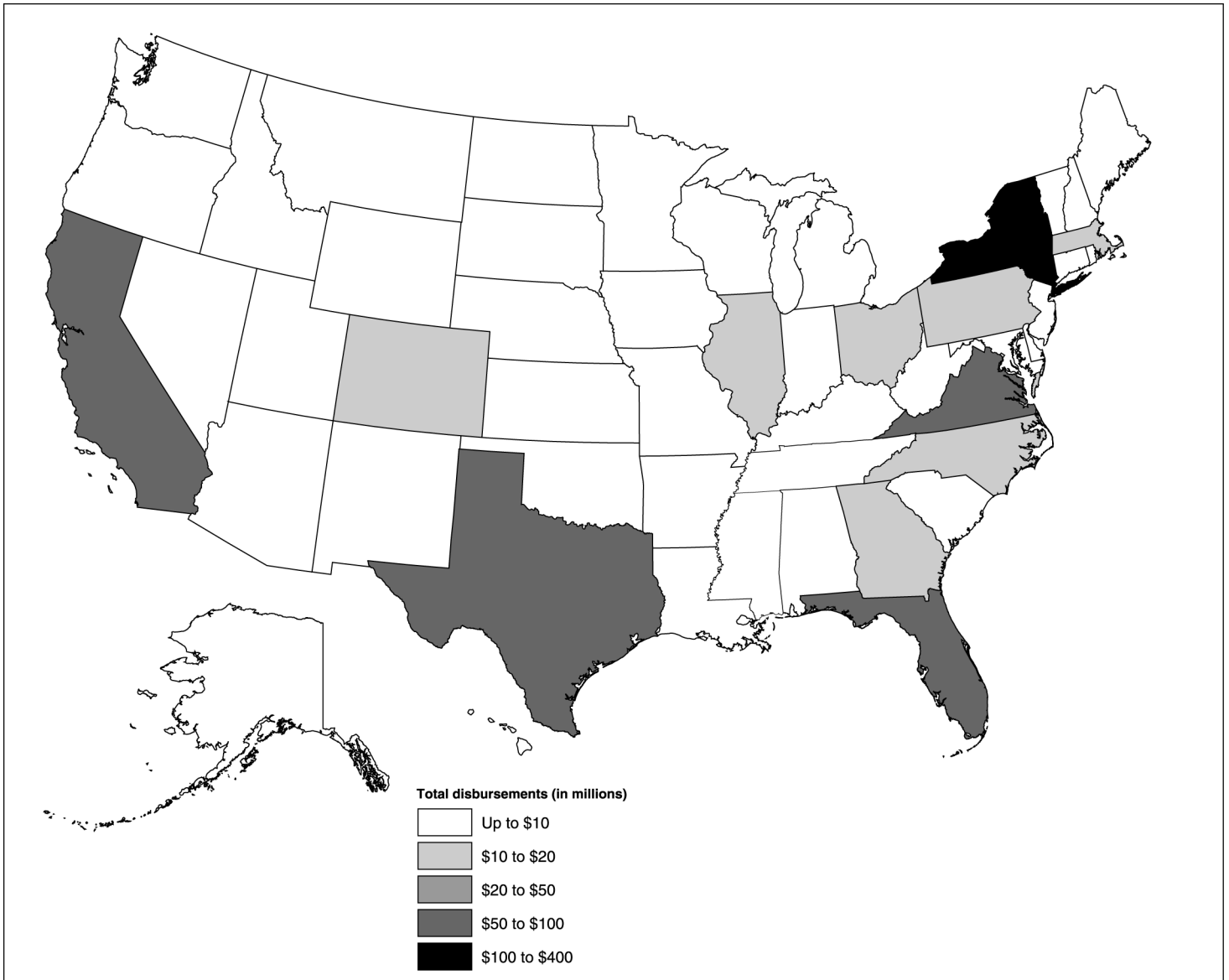
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## SBA Provided Loans to Individuals and Small Businesses Affected by the September 11, 2001, Attacks

SBA's Office of Disaster Assistance makes loans directly to households to repair or replace damaged homes and personal property and help businesses recover from both physical damage and substantial economic losses. SBA's primary objective when responding to disasters is to offer victims quality, timely, easy-to-access, and cost-effective loans to rebuild their homes and businesses.

Since September 11, 2001, SBA has faced the unique challenge of providing loans to restore homes and businesses across the country that were affected by the terrorist attacks. In just over 1 year following the attacks, SBA approved almost 9,700 home and business loans totaling about \$966 million in loan funds to victims of the attacks. Small businesses in those areas of New York and Virginia that were officially declared disaster areas were eligible to apply for both an Economic Injury Disaster Loan (EIDL) and a physical disaster loan to help fund repairs to business property. Certain small businesses nationwide that were affected by the attacks were eligible to apply for an expanded EIDL program, and those affected by the loss of employees who were called up as reserve military personnel could apply for the military EIDL program. Home and business owners in the federally declared disaster areas received just under half of the disbursed loans; the remainder went to eligible businesses nationwide (see fig. 2).

Figure 2: Geographic Distribution of September 11 Related Loan Amounts Disbursed as of September 30, 2002



Source: GAO.

Note: GAO analysis of SBA data.

SBA data suggest that, overall, the agency processed loans related to September 11 faster than it processed loans in response to previous disasters. For example, SBA processed loans to small businesses affected by the attacks in about 13 days on average, compared with about 16 days on average for other business disaster loans during fiscal year 2001. The faster processing may be attributed, in part, to the unique characteristics of the attacks and complaints from small business applicants that prompted SBA and Congress to adapt the loan program for September 11 victims.

SBA's response commenced immediately after the terrorist attacks occurred, when SBA disaster officials established communication with the Federal Emergency Management Agency (FEMA) and state emergency management officials. By the afternoon of September 11, officials from SBA's Niagara Falls area office had arrived in lower Manhattan to begin coordinating the agency's recovery efforts with the overall federal response. SBA officials were meeting with disaster victims by September 13.

In the immediate aftermath of the attacks in New York City, local communications and travel were disrupted. SBA employed two strategies in September 2001 to make it more convenient for victims to apply for SBA loans. First, SBA sent agency officials door-to-door to provide loan applications to businesses. Second, SBA began training officials from other SBA programs with offices in New York, such as the Small Business Development Centers (SBDC), thereby enabling victims to go to other locations in New York to receive disaster loan applications and assistance. Eventually, over 40 SBA locations were available to assist applicants.

In the weeks and months following the terrorist attacks, small business owners complained to Congress about SBA's disaster loan program. Small business owners' complaints involved issues such as (1) the effect of the attacks on small businesses nationwide, (2) SBA's communication with applicants with low English proficiency, (3) size standards for small businesses, (4) loan terms and underwriting criteria, and (5) the time required to receive loan approval. These complaints prompted SBA and Congress to modify the loan program for September 11 victims.

Small businesses complained that eligibility for SBA loans was limited to firms located within the declared disaster areas, yet the September 11 terrorist attacks had caused economic injury to small businesses nationwide. Small business owners, representing aviation-related, travel, and tourism industries from across the nation, reported significant losses

in revenue as a result of the attacks, which forced these owners to furlough and/or terminate numerous jobs. These small businesses identified SBA as a potential source of assistance to help them recover from the economic injury caused by the attacks.

In response to these concerns, in October 2001, SBA made economic injury disaster loans available to small businesses nationwide. SBA's expanded EIDL program enabled businesses outside of the declared disaster areas to apply for loans to meet ordinary and necessary operating expenses that they were unable to meet, due to the attacks or related action taken by the federal government between September 11 and October 22, 2001.

Small businesses complained that the application process was particularly confusing and time-consuming for applicants with low English proficiency. To address these concerns, SBA printed informational packets in languages such as Spanish and Chinese; provided SBA centers with staff who could speak Arabic, Croatian, Mandarin Chinese, and Spanish; and was prepared to send employees with additional language capabilities to application sites. In response to complaints from businesses adversely affected by the terrorist attacks that existing size standards—SBA's official guidelines for determining whether a firm constituted a small business—were overly restrictive, in February 2002, SBA retroactively applied the recent inflation-adjusted size standards to all September 11 economic injury loan applicants. In addition, in March 2002, SBA increased the threshold specifically for travel agencies adversely affected by the attacks from \$1 million to \$3 million in annual revenues.

Small businesses affected by the terrorist attacks also complained that SBA's underwriting criteria for disaster loans were too restrictive. For example, two small business owners testified that SBA withdrew their applications because the owners would not put their homes up for collateral. The business owners argued that it was too risky to put their homes up for collateral, especially since the survival of their businesses was uncertain. A New York SBDC official questioned the appropriateness of SBA's disaster loan underwriting criteria for high-cost areas. He stated that SBA should consider the location of the businesses affected by the attacks—New York City—where some factors relating to the high cost of doing business fall outside of the norms.

Although SBA approved millions in loans, 52 percent of the loan applications related to September 11 were withdrawn or declined. SBA stated that the agency made every effort to approve each application by applying more lenient credit standards than private lenders.<sup>18</sup> However, to minimize costs and losses, SBA officials stated they had to adhere to their credit standards. According to SBA, the most common reason for declining September 11 loan applications was the applicant's inability to repay the loan. SBA officials stand by their decisions not to approve loans that ultimately would result in the loss of a victim's home or business. In addition, we note that such loans would also result in losses to the government.

Finally, applicants complained that it took too long for SBA to approve loan applications. SBA responded to these complaints by implementing procedures in October 2001 to expedite two stages of the process—loan processing and loan disbursements. To expedite loan processing, loan officers calculated economic injury loan amounts on the basis of the applicant's monthly gross margin instead of calculating loan amounts using extensive economic analysis. To expedite the disbursement process, SBA reduced the amount of documentation needed for amounts of up to \$50,000.

Despite SBA's efforts to be responsive to the needs of small businesses affected by the terrorist attacks, business owners asserted that SBA's existing disaster program did not have the authority to provide adequate loans to small businesses within the declared disaster areas. In January 2002, Congress enacted Public Law 107-117. In addition to providing \$150 million in supplemental appropriations, the public law made several changes in the disaster loan program, specifically for small businesses affected by the September 11 attacks. The changes included raising the maximum loan amount from \$1.5 to \$10 million and deferring payments and interest accrual for 2 years.

SBA officials believe that many of the complaints about the disaster program result from a clear difference between victims' expectations of SBA's disaster program and what the program really offers. For example,

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<sup>18</sup>SBA provides loans to the owners of homes and businesses who have no credit available elsewhere at a maximum rate of 4 percent annual interest for up to 30 years. For physical damage to homes or businesses whose owners have credit available elsewhere, SBA provides loans at a maximum rate of 8 percent for up to 5 years.

when some victims are told they can receive “assistance” from SBA, they assume that this assistance is in the form of grants instead of loans. For this reason, SBA officials believe it is important to have a close relationship with the media and public officials so that disaster victims receive accurate information about the nature of SBA assistance.

While it is too early to assess the outcome of SBA’s lending related to September 11, SBA has exceeded all of its process-oriented goals in responding to this disaster. For example, while SBA aims to establish field presence within 3 days of a disaster declaration, SBA officials indicated that they were on site making preparations to serve disaster victims the same day the terrorist attacks occurred. Also, although SBA’s goal is to process 80 percent of disaster loans within 21 days, the agency processed September 11-related loans in an average of about 13 days. In addition, SBA exceeded its goal of making 95 percent of initial disbursements 5 days after receipt of closing documents, ordering initial disbursements in 2 days, on average. Although SBA exceeded all of its timeliness goals in responding to the September 11 terrorist attacks, we have some concerns about the measures and goals that SBA uses to assess its performance in providing disaster assistance.

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## Disaster Loan Program Performance Measures Are of Limited Use

In our June 2001 report,<sup>19</sup> we reviewed SBA’s 2000 performance report, which described its performance for fiscal year 1999, and the 2002 performance plan that described its future program goals. We observed that SBA needed to improve the quality of the measures that it uses to assess its performance and improve its performance plan for the disaster loan program. Specifically, we found that SBA used inconsistent and subjective measures, and that the document used to report program performance to Congress lacked key information that would have provided a more accurate picture of both the performance measures and the results.

Since the June 2001 report, SBA has not significantly improved either its performance measures or the performance plan. We found that two of the measures SBA uses to assess performance describe only one aspect of the loan application and disbursement processes. Moreover, these measures do not capture the notable progress the program has made in improving its

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<sup>19</sup>U.S. General Accounting Office, *Small Business Administration: Status of Achieving Key Outcomes and Addressing Major Management Challenges*, [GAO-01-792](#) (Washington, D.C.: June 22, 2001).



loan processing—progress that ultimately affects disaster loan applicants and borrowers.

SBA currently uses six measures to assess performance—three to assess outputs and three to assess outcomes. The measures that assess the outputs of SBA's service to disaster victims are (1) establishing a field presence within 3 days of a disaster declaration, (2) processing loan applications within 21 days of receiving them, and (3) ordering initial loan disbursements within 5 days of receiving the closing documents. Officials from SBA's disaster area offices who manage SBA's disaster assistance teams questioned whether these measures are appropriate indicators of timely service to disaster victims. For example, one area office official characterized the 3-day field presence measure as artificial and suggested that it does not drive the agency to improve its performance. SBA has met this measure 100 percent of the time since fiscal year 1998. Officials from area offices indicated that planning, interagency coordination, and technology have enabled them to have SBA staff on site and preparing to assist disaster victims within 1 day of a disaster declaration. According to area office staff, delays in establishing a field presence generally occur because SBA is waiting for decisions from state officials.

Several area office officials also questioned the appropriateness of the second measure, which required in fiscal year 2000 that SBA process 70 percent of its loan applications within 21 days of receiving them. In fiscal year 2001, the target was increased to 80 percent. One official suggested that providing timely assistance does not always mean providing assistance in the shortest amount of time. Rather, providing timely assistance depends on the needs of disaster victims. Moreover, SBA exceeded this goal for fiscal years 2001 and 2002. SBA data indicate that in fiscal year 2002, the agency was able to process home loans in about 10 days, on average, and the more complex business loans were processed in about 13 days.

SBA has made several improvements to expedite loan processing. For example, SBA implemented the Disaster Personnel Reserve Corps in order to have trained personnel available to assist in responding to disasters. One field office official thought that the availability of the reserve corps had helped the office attain the 21-day processing goal for fiscal year 2001. In addition, SBA has declined loans with poor credit scores immediately, saving the staff time that might have been spent appraising property for these loans.

In 2002, SBA began reporting data on the third output measure—ordering initial disbursements within 5 days of receiving closing documents. Yet area office staff also question the appropriateness of this measure. Before 2002, SBA had an internal goal of ordering disbursements within 3 days of receiving closing documents. According to officials, when SBA included this measure in the performance plan, the disbursement target was increased to 5 days. Because agency officials are used to being subject to the stricter 3-day standard, they indicated that the 5-day standard can be met with ease. One area office piloted an expedited disbursement process for disbursing loans of between \$25,000 and \$50,000.

SBA uses the next three measures to assess outcomes, or effects, of SBA lending on disaster victims: (1) number of homes restored to predisaster condition, (2) number of businesses restored to predisaster condition, and (3) customer satisfaction. The principal limitation of SBA's measures is that they only account for a portion of the outcomes. For example, SBA reports on the number of home and business loans approved as proxy measures for the number of homes and businesses restored to predisaster condition. But SBA staff explained that even when loans are approved, borrowers might cancel the loan or reduce the amount of the loan to avoid using their home as collateral. Thus, this proxy measure likely overestimates the number of homes and businesses restored. SBA recognizes that these proxy measures are inadequate and is in the process of identifying more accurate ones.

To measure customer satisfaction, SBA uses the results of its survey of successful loan applicants. Yet, every disaster area office director indicated that all disaster victims are SBA customers and that a broader population should be surveyed. In 2001, the SBA Inspector General and we made the same suggestion to SBA. As we indicated then, the current survey method is likely to produce positively skewed responses. However, headquarters officials were resistant to surveying those who were denied loans because they presumed the applicants' responses would be negative. SBA does not currently plan to expand its fiscal year 2002 survey to a sample of all loan applicants.

Like other federal agencies, SBA described its long-term performance goals and associated measures, previously described, in its annual strategic plan for fiscal years 2001 to 2006 and will provide annual reports detailing its progress in meeting these goals. However, in our 2001 report, we found that the fiscal year 2000 performance report for the disaster loan program had several limitations, such as inadequate explanations and inconsistent

or subjective information. Recent performance plans have similar limitations. For instance, the 2003 performance plan does not explain why the strategic goal for the disaster program was changed. In the 2002 plan, SBA defined its performance goal as “helping families and businesses recover from disasters.” In the 2003 plan, that goal has become “streamlining disaster lending”—a shift in focus from an outcome to an SBA process. OMB does not recommend, in its guidance, the approach SBA adopts in its 2003 plan.

In addition, the 2002 and 2003 plans do not explain the linkages between program strategies and achieving performance goals for disaster lending, and do not explain how the performance measures and goals were developed. These omissions make it difficult to understand how and if SBA expects to improve or sustain its loan processing performance.

The performance plans contain incomplete or inaccurate information on some performance indicators. For example, despite Office of Management and Budget (OMB) and SBA guidance, validation and verification information on field presence and loan processing measures is omitted, making it difficult to assess the quality of performance data. In addition, the 2003 performance plan indicates that data on the number of homes restored to predisaster condition are based on on-site inspections of homes. However, SBA officials indicated that the actual source of data for homes restored to predisaster condition is the number of original home loans approved.

In our January 2003 report, we recommended that SBA develop a better performance plan for the Disaster Loan Program.<sup>20</sup> Specifically, the plan needs to include more outcome measures and assess more significant outputs. In addition, we recommended that SBA revise and expand its research to improve its current measures and evaluate program impact. To develop these measures, SBA should conduct research, such as surveying its field staff and loan applicants, to identify both the direct and indirect benefits that disaster victims receive by participating in the program. SBA officials generally agreed with our recommendations.

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<sup>20</sup>U.S. General Accounting Office, *Small Business Administration: Response to September 11 Victims and Performance Measures for Disaster Lending*, [GAO-03-385](#) (Washington, D.C.: Jan. 29, 2003).

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## Strategic Human Capital Management Needs to Be Strengthened

SBA continues to implement some changes in its strategic human capital management<sup>21</sup> and to develop approaches to streamlining its operations, but this critical area still needs to be strengthened. Since we issued our June 2001 status of management challenges report and an October 2001 report on SBA's organizational structure,<sup>22</sup> SBA has continued to build on its vision for modernizing the agency by developing a 5-year workforce transformation plan designed to transform the agency and its workforce "to meet the modern demands of small business."

We reported in October 2001 that SBA's current organizational structure had weaknesses that contributed to the challenges it faced in delivering services to the small business community. Our 2002 review of lender oversight, previously discussed in this report, and the loan asset sales program also substantiated these weaknesses.<sup>23</sup> Organizational alignment can be an important factor in determining an agency's efficiency and ability to administer its programs. By organizational alignment, we mean the integration of organizational components, activities, core processes, and resources to support efficient and effective achievement of outcomes. Specifically, we found that ineffective lines of communication, confusion over the mission of district offices, complicated and overlapping organizational relationships, and a field structure that did not consistently match mission requirements combined to impede staff efforts to deliver services effectively.

Figure 3 illustrates SBA's complex, overlapping organizational relationships, particularly between field and headquarters units. Senior officials said that although some of these complex organizational relationships stem from legislative requirements such as specified reporting relationships, past realignment efforts that changed how SBA performed its functions while leaving aspects of the previous structure intact have also played a part.

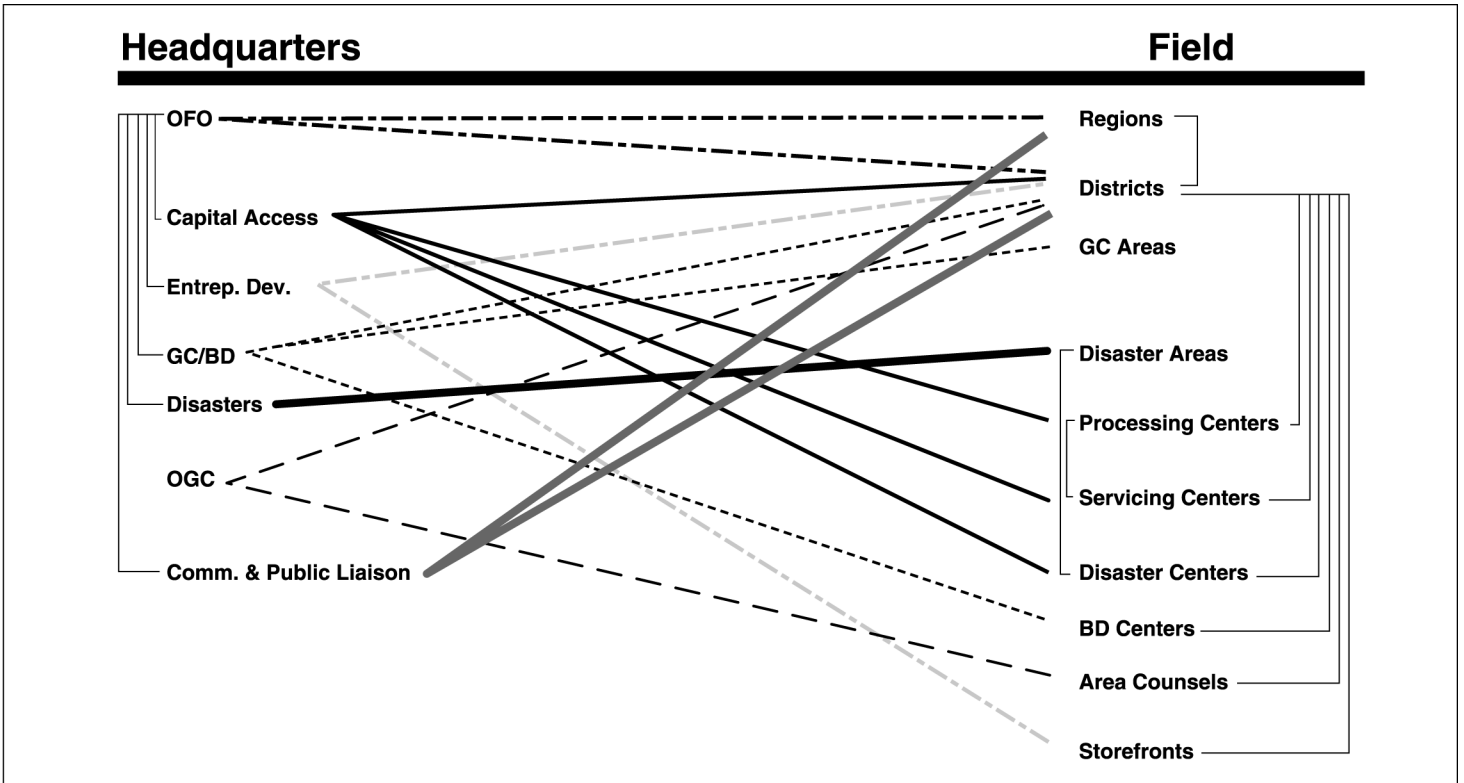
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<sup>21</sup>Key elements of modern strategic human capital management include strategic human capital planning and organizational alignment; leadership continuity and succession planning; acquiring and deploying staff whose size, skills, and deployment meet agency needs; and creating results-oriented organizational cultures.

<sup>22</sup>GAO-01-792 and GAO-02-17.

<sup>23</sup>GAO-03-90 and U.S. General Accounting Office, *Small Business Administration: Accounting Anomalies and Limited Operational Data Make Results of Loan Sales Uncertain*, GAO-03-87 (Washington, D.C.: Jan. 3, 2003).

Figure 3: Organizational Relationships among SBA Headquarters and Regions, Districts, and Other Field Units



Source: GAO.

Notes:

GAO analysis of SBA organization.

This figure refers to the following SBA offices: Office of Field Operations (OFO), Office of Government Contracting/Business Development (GC/BD), Office of the General Counsel (OGC), and Government Contracting Area Offices (GC Areas). This figure also uses the term "storefronts" to characterize Small Business Development Centers, Business Information Centers, Women's Business Centers, and other such locations where the public accesses SBA programs.

For example, the district offices have a direct relationship not only with both the Office of Field Operations and a regional office, but also with the headquarters offices managing their programs. District staff working on SBA loan programs report to their district management, while loan processing and servicing center staff report directly to the Office of Capital Access in headquarters. However, staff from district office loan programs sometimes need to work with the loan processing and servicing centers to get information or expedite loans for lenders in their district. Because loan processing and servicing centers report directly to the Office of Capital Access, requests that are directed to the centers may go from the district through the Office of Capital Access then back to the centers, complicating efforts to process and service loans quickly and efficiently. SBA district officials told us that these multiple lines of communication with the district offices have resulted in conflicting or redundant requests and difficulty communicating priorities. SBA's Inspector General found similar communication problems within SBA.<sup>24</sup>

We also found confusion about the primary role of SBA's district offices. Headquarters executives said that the main customer of the district offices was the small business community. However, district office officials told us that their primary clients were the lenders that they worked with, that is, encouraging the lenders to make more SBA guaranteed loans, providing support, and conducting oversight reviews. SBA headquarters executives said that the role of the district office had been in transition since the agency had begun centralizing lending activities. But district office officials noted that they were still responsible for interacting closely with lenders, especially small lenders, and have a role in servicing problem loans and liquidating defaulted loans.

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<sup>24</sup>U.S. Small Business Administration, Office of the Inspector General, *Advisory Memorandum: Report on the Results of SBA Management Challenge Discussion Groups*, #01-04-01 (Apr. 4, 2001).

SBA continues to deal with the problem of getting properly trained people into the right places, especially the districts, to manage the 7(a) and 8(a) programs. SBA officials said that 7(a) staff had seen their roles change from loan processing to overseeing financial institutions, and that 8(a) Business Opportunity Specialists were facing a similar change from monitoring program compliance to acting as business development coaches. Likewise, our review of the role of SBA's Commercial Market Representatives—staff who promote small business subcontracting—found that although SBA had changed what these representatives did, it had not strategically planned these changes or assessed their collective impact.<sup>25</sup> We recommended that SBA strategically assess, evaluate, and plan the role of these staff. SBA agreed that it needed to rethink the market representatives' role and develop outcome and impact measures to better assess their effectiveness. In addition, SBA's 5-year workforce transformation plan addresses the need to inventory the skills of all SBA employees and provide professional development opportunities as needed.

Since 1999, SBA has been selling its disaster assistance and defaulted business loans to reduce the amount of debt it services so that the agency could realign employees to focus more on serving small businesses. However, the role of loan asset sales in facilitating a realignment of SBA's workforce may be less than initially expected. In our January 2003 report<sup>26</sup> on SBA's loan asset sales, we found that although loan servicing workloads have been reduced, the reduction has not yet translated into moving employees out of servicing positions and into more mission-critical positions. Some of the benefits SBA had expected may not materialize or SBA may have overstated them. Furthermore, some district office officials were doubtful that the loan sales would significantly reduce their role in servicing and liquidating business loans, since most of the loans SBA has sold were from the disaster assistance program. We recommended that SBA more thoroughly analyze the benefits and other effects of loan asset sales on agency operations. In commenting on our draft report, SBA did not specifically respond to this recommendation. SBA's 5-year workforce transformation plan acknowledged the need to provide professional development opportunities for any employees affected by realigning resources due to the asset sales or other changes.

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<sup>25</sup>U.S. General Accounting Office, *Small Business Administration: The Commercial Marketing Representative Role Needs to Be Strategically Planned and Assessed*, [GAO-03-54](#) (Washington, D.C.: Nov. 1, 2002).

<sup>26</sup>[GAO-03-87](#).

According to the administration's executive branch management scorecard report for SBA,<sup>27</sup> SBA recognizes the need to restructure but made little progress in doing so during fiscal year 2001. The 5-year workforce transformation plan recognizes SBA's need to restructure its workforce, privatize noncore functions, adjust incentives and goals, and streamline its headquarters' operations. SBA's leaders have acknowledged the major elements we have identified that underpin a successful workforce transformation—strategic planning; strategic human capital management; senior leadership and accountability; alignment of activities, processes, and resources to support mission achievement; and internal and external collaboration.<sup>28</sup> They plan to use these elements to guide the agency as it pursues workforce transformation.

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## SBA Has Made Some Progress in Improving Its Information Technology, but More Remains to Be Done

In May 2000,<sup>29</sup> we reported that SBA had not established policies and defined processes in a number of critical information technology (IT) areas, including IT investment management, IT architecture, software development and acquisition, information systems security, and human capital management. As a result, SBA could not ensure that it was effectively selecting and controlling its IT investment management, ensuring its systems are compatible and would meet agency needs, performing essential software development and acquisition activities, protecting critical information and assets from inappropriate use, and identifying the knowledge and skills needed to support its IT management mission. We made a number of recommendations in that report to improve SBA's IT management capabilities. SBA has made progress on some of our recommendations, such as setting a target date for the implementation of architecture maintenance procedures. However, SBA has not provided evidence that it has completed actions to implement significant portions of all the recommendations made in May 2000. Therefore, the agency cannot

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<sup>27</sup>The Executive Branch Management Scorecard is a grading system used by the administration to grade agencies' efforts at executing management improvements in the areas of human capital, competitive sourcing, financial management, e-government, and budget/performance integration.

<sup>28</sup>U.S. General Accounting Office, *Management Reform: Elements of Successful Improvement Initiatives*, [GAO/T-GGD-00-26](#) (Washington, D.C.: Oct. 15, 1999) and *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: June 1996).

<sup>29</sup>U.S. General Accounting Office, *SBA Needs to Establish Policies and Procedures for Key IT Processes*, [GAO/AIMD-00-170](#) (Washington, D.C.: May 31, 2000).



ensure that policies and practices are in place to effectively acquire and manage its IT resources. We will continue to monitor SBA's progress in addressing weaknesses in each of these critical IT areas.

In the investment management area, we recommended that SBA adopt policies and procedures for selecting, controlling, and evaluating its IT investments. Since we made our recommendations, SBA has initiated efforts to select and control its major IT investments—including prioritizing projects for investment and tracking some projects' progress on cost and schedule milestones. However, SBA has more to do to complete its selection and control processes—such as developing a standardized cost-benefit methodology and implementing control procedures for major IT projects. SBA has not initiated postimplementation reviews.

To ensure that its systems were compatible and met agency needs in the IT architecture area, we recommended that SBA create a process for developing its architecture and establish policies and procedures for maintaining its architecture to ensure the compatibility of its systems and software. SBA has not yet implemented policies and procedures for architecture development and maintenance. However, SBA officials reported that they expect to have a maintenance policy in place by February 2003.

In the software development and acquisition area, we recommended that SBA establish and enforce an agencywide systems development methodology as well as policies and procedures for software acquisition and development. Since we made those recommendations, SBA has established its systems development methodology but has not yet established policies and procedures for software development and acquisition.

In the area of information systems security, we made a series of recommendations to improve SBA's ability to identify, address, and manage security risks. Since we made our recommendations, SBA has established policy and procedures for information systems security, made progress in ensuring the security of 38 of its most sensitive computer systems, and developed computer security awareness training. However, in January 2002, SBA's Inspector General raised concerns about agencywide security management, systems access controls, and computer security testing.<sup>30</sup>

In the human capital management area, we recommended that SBA undertake a series of steps to identify its information technology knowledge and skills requirements, assess its current information technology skills, and develop strategies to acquire and maintain information technology skills. Since we made our recommendations, SBA has completed a technical skills assessment for IT staff, but is still in the early stages of examining its workforce needs. In addition, according to its fiscal year 2003 performance plan, SBA intends to collect and maintain data on IT skills requirements and staff IT skills.

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## Challenges Still Exist to Achieving Budgetary and Financial Accountability

SBA faces major challenges before it can achieve financial accountability. Most notably, it needs to address problems in accounting for and reporting its loan asset sales and the subsidy allowance account. These problems have impacted past and could impact future subsidy cost estimates and the opinions on SBA's financial statements. SBA also continues to experience problems with its overall financial reporting process.

In our recently issued report on SBA's loan asset sale program,<sup>31</sup> we reviewed SBA's budgeting and accounting for loan sales and found that SBA incorrectly calculated the accounting losses on the loan sales and lacked reliable financial data to determine the overall financial impact of the sales. Further, because SBA did not analyze the effect of loan sales on its remaining portfolio, its reestimates of loan program costs for the budget and financial statements may contain significant errors. In addition, SBA could not explain significant declines in its loss allowance account for disaster loans. Until SBA corrects these errors and determines the cause of

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<sup>30</sup>U.S. Small Business Administration, Office of the Inspector General, *Most Serious Management Challenges* (Jan. 16, 2002).

<sup>31</sup>[GAO-03-87](#).

the precipitous decline in the loss allowance account, SBA's financial statements cannot be relied upon. Further, the reliability of current and future subsidy cost estimates will remain unknown. These errors and the lack of key analyses also mean that congressional decision-makers are not receiving accurate financial data to make informed decisions about SBA's budget and the level of appropriations the agency should receive. We recommended that, before conducting additional loan asset sales, SBA correct the accounting and budgeting errors and misstatements. SBA generally agreed with our overall findings and recommendations, especially the need to better assess the financial impact of SBA's loan sales program. SBA also stated that it is actively engaging a contractor to help resolve the accounting and budgetary issues and has worked extensively with its independent auditors to identify causes and options for resolving the issues we identified. Furthermore, we recommended that the Inspector General, in conjunction with SBA's independent auditors, assess the impact of any identified errors in the financial statements and determine whether previously issued audit opinions for fiscal years 2000 and 2001 need to be revised. The Inspector General and SBA's independent auditors agreed with our findings and informed us in December 2002 that SBA's independent auditors plan to withdraw their unqualified audit opinion on the fiscal years 2000 and 2001 financial statements and issue disclaimers of opinion. The independent auditors have stated that their audit opinions for 2000 and 2001 should no longer be relied upon because they may be materially incorrect due to the errors identified in our report on SBA's loan asset sales program.

In addition to problems in accounting for loan sales and the subsidy allowance, SBA's overall financial reporting process remained a material internal control weakness in fiscal year 2001. Documentation of the financial reporting process and procedures improved; however, the independent public accountant reported that the overall process worsened. For example, SBA did not deliver its financial statements to the independent public accountants performing the fiscal year 2001 audit by the originally scheduled dates. SBA provided revised dates extending delivery of financial statements and supporting documentation by 11 to 21 days. When finally delivered, the financial statements contained numerous errors and misclassifications. For example, nearly \$350 million in gross costs were reported under the wrong line item on the Statement of Net Cost, and \$1.1 billion of offsetting receipts were excluded from the Statement of Financing when the correct amount had already been reported on the Statement of Budgetary Resources. Neither SBA's process for preparing the financial statements nor its quality assurance process

identified these errors before the statements were submitted to the auditors.

The deficiencies in SBA's financial reporting process meant that the agency did not substantially comply with the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA is a measure of an agency's ability to incorporate into its financial management system accounting standards and reporting objectives established for the federal government, so that all assets, liabilities, revenues, expenses, and the full costs of programs and activities can be consistently and accurately recorded, monitored, and uniformly reported. Substantial noncompliance with FFMIA indicates that SBA's financial management systems do not routinely provide reliable, useful, timely, and consistent information to fulfill its responsibility of being accountable to the public and of providing timely financial information to manage on a day-to-day basis.

In August 2001, we reported that, on a cumulative basis since 1992, SBA had overestimated the defaults on the 7(a) General Business Loan Program by approximately \$2 billion and had overestimated recoveries by approximately \$450 million.<sup>32</sup> Because cash flow modeling is both complex and imprecise, agencies generally revise their estimates annually. SBA's modeling approach used a higher default rate than recent experience because they included more years of historical data to smooth out fluctuations in economic conditions from year to year. This practice provides a cushion in the event of an unexpected economic downturn. Since this time, SBA proposed several changes in the default estimation methodology and has recently completed work on a sophisticated econometric modeling approach to address this issue.

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<sup>32</sup>U.S. General Accounting Office, *Small Business Administration: Section 7(a) General Business Loans Credit Subsidy Estimates*, [GAO-01-1095R](#) (Washington, D.C.: Aug. 21, 2001).

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